Q&A: Sen. Mark Warner wants 'guardrails' to support CDFIs

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WASHINGTON — Sen. Mark Warner, D-Va., has big plans for the future of community development banking, but he also has big concerns about risks piling up outside of the banking system.

In a phone interview with American Banker on Friday morning, Warner spoke at length about community development financial institutions — Treasury Department-certified lenders designed to specialize in low-to-moderate-income lending, better known as CDFIs. Warner sees a larger role for CDFIs to play in the banking system as the goal of reaching underserved communities has become a major priority for financial policymakers in recent years.

A member of the Senate Banking Committee, Warner said that although he'd been familiar with local CDFIs as governor of Virginia in the 2000s, the initial rollout of the Paycheck Protection Program put the sector front and center of lawmakers' efforts to better distribute pandemic-era emergency loans to businesses operating in underserved communities of color — a well-documented challenge in the early months of 2020.

The Paycheck Protection Program's first round "was well intentioned," Warner said, "but a lot of communities of color didn't get to fully participate, because so many Black- and brown-owned businesses, for example, aren't going through a traditional bank. They're often bootstrapped by friends and family or community."

More than two years later, in early August, Warner announced a new bipartisan caucus in the Senate that would be co-chaired with Republican Sen. Mike Crapo of Idaho and dedicated to CDFI issues. Among the group's priorities, Warner said, would be fostering a secondary market for CDFI debt and encouraging greater private investment in the sector by introducing new tax breaks, particularly for investments of what he calls "patient" capital.

Warner also said it would be critical to set the CDFI sector up for success before an inevitable economic downturn, which will likely impact their low-to-moderate-income borrowers the hardest.

"I want to set expectations the right way," Warner said. "When — because it's a question of when, not if — we have an economic downturn, we need to make sure there are some guardrails for these marginalized communities. We don't want to see a couple of CDFIs go under and have policymakers asking if this was the wrong approach."

Beyond community lending, Warner also discussed the state of American cybersecurity amid the Russian invasion of Ukraine, particularly among banks. Nearly seven months in, Warner — who also serves as chairman of the Senate Intelligence Committee — told American Banker that "because our financial sector has been focused on this for so long, it's probably among the better-prepared sectors" for cyberwarfare.

But Warner also warned about the risks of complacency, arguing that elevated threats to banks' operations could persist for some time.

"The thing I worry about is fatigue," Warner said. "How long can we maintain this higher level of protection and scrutiny? But at least so far, I'm pretty pleased."

The Virginia senator also mused on the state of financial regulation outside the banking system and bemoaned the lack of a "whole framework" for supervising the nondepository system.

"The finance sector continues to evolve so quickly. What is it now — maybe half the financing entities in this country are nondepository, nonregulated banks?" Warner said. "I'm very concerned about that whole sector. It might be that I'm tied up by other legislation and being the intelligence chairman, but I don't see anybody saying, 'OK, here's a whole framework of how we ought to think about the nonbank financial sector.' "

The following conversation has been condensed and lightly edited for clarity.

I've heard you say on the Senate Banking Committee that as a businessman, you've had firsthand experience with CDFIs and know how important they can be for entrepreneurs. Can you walk me through that experience?

SEN. MARK WARNER: My background was as a struggling entrepreneur. My first two businesses failed miserably — one was an energy startup, then real estate, and the third time was the charm in the wireless industry. But I remember early on that, if you didn't have established banking relationships, access to capital becomes a huge challenge. And we know that disproportionately, capital has historically been less available to women, people of color, and to many rural communities. Especially for the African American community. The 2008 financial crisis was a real disaster for minority depository institutions, for Black-owned institutions. We lost, literally, the overwhelming majority of them — I believe the actual number is in the mid-20s, currently.

I became familiar with CDFIs in the 1990s as an institution that needs to do at least 60% of their activity in low and moderate income communities. But CDFIs have grown beyond just traditional depository institutions — you've got credit unions and loan funds, and a lot of communities have got these institutions today. We've got 16 in Virginia, and I became especially interested in them when I was governor in the early 2000s. We started Virginia Community Capital, which became a statewide development bank.

I've always been interested in these issues around access to capital in underserved communities. But what really drove it home for me was the first round of [the Paycheck Protection Program]. It was well intentioned, but a lot of communities of color didn't get to fully participate, because so many Black- and brown-owned businesses, for example, aren't going through a traditional bank — they're often bootstrapped by friends and family or community. So that first round of PPP money went out, and suddenly, we had lost 100,000 Black-owned businesses, about 25% of minority-owned businesses. I don't really think it was necessarily a case of bias, but the regional banks and community banks went first and foremost to their customers, and those customers tend to be more traditional businesses. So it became evident to me that we were missing the ability to distribute [funds to underserved communities].

But the real untold story was, as I was making the case amid COVID negotiations, my best ally on this ended up being Treasury Secretary Steven Mnuchin, because he had a background in finance. He understood that there were these underserved communities, and he helped convince President Trump that this would make sense. I still remember President Trump bragging about how we were going to be able to get $100 billion in lending to Black and brown communities. But Steven became a real stalwart on this, and we put together a $12 billion program to do it. And my other great partner was Sen. Mike Crapo [R-Idaho], who had seen what CDFIs can do in rural communities in Idaho. And then you had the usual suspects: then-Sen. Kamala Harris [D-Calif.], Chuck Schumer [D-N.Y.] and Cory Booker [D-N.J.]. It was an interesting collaboration.

In August, you and Sen. Crapo announced a bipartisan Senate caucus dedicated to the CDFI industry. What are your legislative priorities? What will success look like for the industry if you have your way?

There's a couple of pieces of legislation I want to briefly talk about, but I want to set expectations the right way. When — because it's a question of when, not if — we have an economic downturn, we need to make sure there are some guardrails for these marginalized communities. We don't want to see a couple of CDFIs go under and have policymakers asking if this was the wrong approach. By nature of the business, if you're lending 60% to LMI communities, some loans are going to be more challenging. So that's why I wanted a caucus: to be able to broadly support the sector and, if we need to, make tweaks in terms of regulatory oversight and make sure the regulators are familiar with the challenges of lending into these communities. We've got work to do.

The first bill we have is one with my friend Sen. Bill Haggerty [R-Tenn.]. There's been a lot of research done about how, it's great to get Tier 1 capital into these institutions, but we often need a secondary market, so you have the ability to have some entity purchase these loans. That was authorized in statute already, but it's never been funded. So we're doing a relatively small, experimental, $100 million program that could start purchasing some of these loans. That's a fairly small bill that we'd like to get attached to something. Then, we have a second, broader bill with Sens. Cindy Hyde-Smith [R-Miss.], Roger Wicker [R-Miss.], and Chris Van Hollen [D-Md.]. We're saying, let's put a CDFI tax credit in place, so you get favored tax treatment if you invest in CDFIs with patient capital — a minimum of 10-year investment, and then you can get a slightly bigger tax benefit if you invest patient capital in a 20-year investment.

Otherwise, I'm continuing to work with the regulators to make sure there's a recognition that this is a slightly different part of the financial industry — a relatively small slice of the banking industry in America, obviously, but I think it's an area that's got huge potential for growth and broad, bipartisan support.

In terms of success, I would hope the CDFI sector would become a much better known and sizable segment of the banking industry. What the percentage is, I don't know. But the fact is that there are still many members of the Senate, members of Congress, and frankly a lot of business leaders who don't even know what CDFIs are. I think a second level of success would be a happy, healthy secondary market in CDFI debt instruments. That would show that the market has matured. And on a third level, where the rubber really hits the road is: are we seeing these issues around capital access resolved, particularly startups among women and within minority communities? Are we going to see the kind of uptick we've hoped for that's actually commensurate with the size of their populations?

This doesn't all have to be done by CDFIs, of course. But if they become healthy enough that they can press traditional community banks and even the regional banks into being more forward-leaning and lending to these communities, that would be success as well.

I know cybersecurity has historically been a big issue for you, especially among banks. The Russian invasion of Ukraine prompted a lot of U.S. security experts to highlight the rising risks of cyberattacks across the West. As we approach the seventh month of the war, how concerned are you about the cybersecurity around the financial services sector?

Speaking as the chairman of the Senate Intelligence Committee, I still think that cyber has been the dog that didn't bark in the Russian war. You have people like our friends at Microsoft who are doing a great job in forewarning us. [The Cybersecurity & Infrastructure Security Agency] has done a very good job with their Shields Up program. We are a lot better at defense than we used to be. But I still don't believe that we've seen Russia unleash its ultimate tools yet.

Candidly, if you go back to the NotPetya attack, launching these cyber attacks is a lot like putting something out into the wild where, once the bug is out there, you don't know where it's going to end up. NotPetya did a lot of damage in Ukraine and across the West, but it also rebounded and did lots of damage inside Russia. So for whatever reasons, the Russians have not launched their most ferocious weapons or tools, I think partly because they don't want to escalate or don't want the West to respond in kind.

I do think that because our financial sector has been focused on this for so long, it's probably among the better-prepared sectors. There's always some intel that we may see Russia attack our financial or energy sector, and I continue to follow this very closely. So far, so good. The thing I worry about is fatigue. How long can we maintain this higher level of protection and scrutiny? But at least so far, I'm pretty pleased.

I'd like to hit another oldie-but-a-goodie issue — GSE reform. We didn't secure that reform under the Trump administration, and it doesn't seem to be a focus for the Biden administration. As we potentially head into a recession, are you concerned about the impact that the lack of reform could have on the housing finance system?

This is a bit of a weird analogy, but GSE reform is like pushing the rock up the hill and it comes right back down. I spent years and years doing this, and my partner was [former Republican Sen.] Bob Corker. We had this major GSE reform effort to break up the institutions and have a more competitive model, not just a duopoly. It had broad support from the Obama administration, and it failed miserably.

It feels like the status quo rules the day in this area. I know more about housing finance than I ever wanted to know. But I also have to say, it's extremely complicated. There's a reason why, at this level of complexity, it's so hard to get a legislative fix. It's just one of those things where there doesn't seem to be a lot of will to move. It's frustrating, because one part of our reform would have included a 10- or 15-basis-point fee on all mortgages to have a dedicated revenue stream for housing trust funds, first-time homebuyers — things that would have been quite helpful today. But I'm not holding my breath on this one.

Let's talk about the regulatory perimeter and nonbanks in the financial system. Where do you see the most immediate need for congressional action? Is there any particular area outside the regulated financial system where we really need to zero in? I guess what I'm really asking is, what risks in the nonbank sector keep you up at night?

First of all, crypto. My background was in technology. I'm all for innovation. But I continue to see a lot of potential challenges for crypto in terms of misuse and abuse. What advocates seem to tout the most is, "I want to be able to send money 24/7 to any country, maybe one with an unstable currency." That, to me, seems to be a fairly small piece of what has actually grown to be a fairly robust, but speculative, industry.

I'm trying to continue to educate myself in this field. I don't want to move rashly. But if you look at a peer competitor like China and what they've done in terms of shutting down crypto — I'm not for a shutdown. But I do believe there needs to be a regulatory framework. I'm still trying to educate myself on what that should look like, so that keeps me up.

The other thing is — I'm still proud of S. 2155 [the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018]. For non-[systemically important financial institution] banks, there were some parts of Dodd-Frank we may have overdone, and I think we've lessened a bit of that regulatory burden. But the finance sector continues to evolve so quickly. What is it now — maybe half the financing entities in this country are non-depository, non-regulated banks? I'm very concerned about that whole sector. It might be that I'm tied up by other legislation and being the intelligence chairman, but I don't see anybody saying, "OK, here's a whole framework of how we ought to think about the non-bank financial sector."

The question is, can our existing regulatory structure be used to regulate nonbanks**.** Remember — there was a lot of debate about the OCC and whether there should be a charter for some fintech-type entities out there. There's an argument on both sides, but I actually think I'm leaning more these days towards some level of charter granting, so at least we can put some kind of regulatory umbrella over what is a huge, growing sector getting access to capital and financing. I'm worried that we're going to look pretty silly if there's some huge downturn or crisis in the fintech world, the nonbank world, and we don't have any visibility into that sector, because we've got no regulatory structure at all for it. That keeps me up at night.